This record is a partial extract of the original cable. The full text of the original cable is not available.

UNCLAS SECTION 01 OF 03 SANTO DOMINGO 006062

SIPDIS

DEPT FOR WHA/CAR, WHA/EPSC, EB/IFD/OMA;
TREAS FOR LCARTER

E.O. 12958: N/A
TAGS: ETRD EFIN DR PGOV
SUBJECT: IFIS ON DOMINICAN FINANCES - TIGHT TIMETABLE WITH
A LONG WAY TO GO FOR STANDBY

¶1. (SBU) Despite progress on institutional reforms, the Dominican government still has a number of decisions to make before a new standby agreement can be reached with the IMF. Concerns about electricity sector reforms and and unanswered questions on fiscal problems mean that a tentative IMF Board date of December 13 might be overly optimistic. A Dominican technical team plans to begin talks with the Fund in Washington the week of November 8, with political negotiations scheduled to begin November 15.

Progress, but still more holes

¶2. (SBU) On November 1, local IMF, IDB and World Bank representatives met with the Ambassador to review the status of a new agreement. IMF resrep Ousmene Mandieng (protect) told the Ambassador that the Dominican Republic has made significant progress on institutional reforms in preparation for an agreement, but added that many questions remain regarding electric sector problems, budget measures and the incomplete fiscal reform. On the positive side, the government has increased the independence of the Central Bank and Banking Superintendency and also improved efficiency of debt management.

¶3. (SBU) Plans on timing of bank recapitalization and monetary policy have also progressed. By the end of December, all banks must reach a 10 percent capital adequacy rate based on national standards, but will be given until the end of 2007 to reach international banking standards. At present the size of the gap between local and international norms is not clear. While this is not ideal from the IMF perspective, Mandeng said, the long grace period was part of the original IMF standby agreement. The Central Bank is moving to lengthen the duration of Central Bank certificates from the present one to six months to one to five years, and also plans to try to lower the cost of debt by substituting dollar linked debt for peso debt. The Central Bank (CB)has been able to lower interest rates in recent months but they are still high in nominal terms (up to 30 percent in the last auction). Interest on the CB certificates is equivalent to 4 percent of GDP; he expects that it will fall to about 1.5 percent of GDP in 2005.

¶4. (SBU) Not enough progress has been made on fiscal reform. Tax legislation passed in September did not provide the revenue originally sought and now any residual fiscal adjustment will have to be taken from the expenditure side, since the government has declared publicly that there will be no further tax increases. There is no clear plan for where cuts will be made or how the Dominican government is to control contracting of new internal debt. Cuts will have to come largely from current expenditures, not from the capital budget.

¶5. (SBU) For the troubled electricity sector, the IMF still requires from the government 1) credible projections of the monthly energy subsidy payments and transfers in order to calculate the budget ceilings; and 2) identification of specific concrete steps to be taken to reduce theft, improve collections and focus subsidies. It is also still unclear where the Dominicans will secure much-needed external financing.

¶6. (SBU) A small delegation led by Julio Ortegawent to New York last week to speak with commercial banks and bondholders, but no news of results is yet available. Dominican technicians will begin talks with the Fund in Washington during the week of November 8; political negotiations involving Technical Secretary Montas, Finance Minister Bengoa and Ortega are expected for November 15.

Details and pre conditions

¶7. (SBU) Mandieng said that a new Fund program would probably be worth $600 million over 24-28 months. Funds would be deposited in the Central Bank and could not be used to support the budget but only to finance the balance of payments gap. The program would be a continuation of the

general lines of the previous agreement but would be more focused on institutional strengthening, with a tax reform required in 2006.

¶8. (SBU) Preconditions for the standby will include further consolidation of fiscal management under the Secretary of Finance. Debt decisions currently managed by the Technical Secretary's office need to be transferred to Secretary of

SIPDIS
Finance, as does responsibility for the Office of the Budget. The IMF also requires that the government procurement process be made more transparent.

¶9. (SBU) Whether or not a congressional approval of the 2005 budget will be required for an IMF agreement hinges on timing. If the IMF agreement approval process slips into January, the IMF would probably require congressional approval of the 2005 budget. Even in the case that a congressionally approved 2005 budget is not required, an accurate and clear estimate of the level of internal debt, government payroll and revenues and all other budgetary information would be required by the IMF.

¶10. (SBU) Still unclear is the process to be used to liquidate government assets, some acquired in bank liquidations last year. The Central Bank governor wants to set up an independent agency to liquidate assets (both those acquired from recently failed institutions and assets owned by the Central Bank over a longer period).

¶11. (SBU) The IMF will require the Dominicans either to continue servicing bonds or to demonstrate that they are actively renegotiating them, in which case the IMF can lend into arrears. There is currently $63 million in non-reschedulable debt that must be cleared by the end of December in order to meet Paris Club and IMF requirements.

¶12. (SBU) The long discussed deal for cheap oil from Venezuela is a bright spot and constitutes direct budget support. It will offer generous terms of 2 percent interest over 15 years to finance 25 percent of 50,000 barrels a day of imported Venezuelan crude. This will be worth $200 million or more per annum. Even so, the IMF model suggests that the government will have to find between $300 million and $400 million to close the gap, much more than might be realized through a bond rescheduling.

¶13. (SBU) The IMF model uses projections of the exchange rate in 2005 at 37 versus the current 32 per dollar; GDP growth is predicted at 1.8 percent in 2004 and 2.5 percent in 2005; oil will be at $50/barrel; inflation will be 12 to 15 percent, with an end-2005 projection of 13.5 percent; expenditures on the electricity sector will be $400 million in 2005; and the free trade agreement will not be implemented before the end of 2005 (so that no adjustment will be required for loss of customs revenues until 2006).

World Bank and IDB waiting

¶14. (SBU) World Bank Country Manager Christina Malmberg said that her agency has a loan of $100 million outstanding, $50 million of which was paid out in March with the remaining $50 million pending, held up for lack of an IMF agreement. If the planned agreement goes to board, $25 million will be released for the energy sector. The remaining $25 million for social sector expenditure will require the Dominican Republic to meet eight conditions, on all of which the Dominicans are still far short. The World Bank loan authorization terminates in December 2004, and the Bank wants clear progress on conditionality before it will be willing to extend the loan offer for three months. The World Bank also has two modest technical assistance loans for energy and financial management pending congressional approval, one of which is 60 percent earmarked for the Banking Superintendency.

¶15. (SBU) IDB Representative Moises Pineda said that the IDB has an outstanding loan of $250 million, with $50 million earmarked for social spending remaining to be distributed, pending the IMF agreement. IDB has requested an audit of the first disbursement to ensure that it was used appropriately. The government has continued to pay electricity generator COGENTRIX. If the government contract with COGENTRIX falls into arrears or is abrogated, the IDB will have to pay a $70 million guarantee, triggering calls on Dominican sovereign guarantees of $400 million, undermining any IMF agreement.
HERTELL